Proposed energy counter-reform in Mexico

October 2021

On September 30, 2021, the Executive Branch of the Mexican Federal Government submitted a bill to amend articles 25, 27 and 28 of the Political Constitution of the United Mexican States (the **Reform Bill**). If approved, this measure would, among others, repeal the constitutional reform of the electricity sector passed on December 20, 2013 (the **2013 Energy Reform**), restore the state-dominant position in Mexico's electricity industry through the Federal Electricity Commission (**CFE**) and limit and control private participation in power generation, removing at a stroke the regulatory agencies that currently govern the national electricity system and the wholesale energy market.

The Reform Bill was submitted by the president of Mexico following a sundry of legal actions at the Mexican courts filed by private power generators, major off-takers and the Mexican Antitrust Commission against the government (which the latter lost) in connection with a series of regulatory and administrative provisions that were *de facto* signs of the intention to undo the 2013 Energy Reform.

The Reform Bill proposes the revocation of all power generation permits awarded to private producers as well as related contracts, and strictly limits the generation of electricity for its exclusive sale to CFE, substantively modifying the electric market.

In addition, the Reform Bill entrusts CFE with widest discretionary powers, becoming the planner, controller and regulator of the Mexican electricity sector (including private generation).

The Reform Bill may result in potential adverse effects to private energy producers and consumers.

The Reform Bill

The most important features of the Reform Bill are as follows:

- Restoration of state-dominant power in this sector by means of vertical and horizontal integration at CFE, the state-owned entity holding the exclusive authority to generate, conduct, transform, distribute and supply electricity in Mexico. In line with this, the Reform Bill proposes declaring the energy sector as a strategic area to be conducted exclusively by the Mexican State.

- Limitation of electricity generation by private generators (capped at 46% of total production) whereby independent power producers would continue to exist (through the sale of all energy to CFE), all supply derived from long-term auctions must be sold to CFE, and only "genuine" energy self-supply (isolated supply and co-generation) would be permitted.

- Private power generators that continue to exist may compete in the sale of electricity and capacity to the CFE, offering their lowest sell prices (production cost) in the short and long term. This would require that new contracts be signed with the CFE; contract terms would be defined unilaterally by the CFE at its discretion.

- The regulator of the energy sector, the Energy Regulatory Commission (CRE) would disappear, leaving the regulation of different activities to the Ministry of Energy (SENER). The National Energy Control Center (CENACE) would also cease to exist as an independent operator of the national electricity system and would be reincorporated into the CFE where its sole remit would be to handle CFE's energy purchase from private generators.

- Total overhaul of CFE's legal nature which would cease to be a "productive company of the State" and restore its status as state-owned entity. CFE subsidiary companies involved in power generation,

transmission and distribution would also disappear and their functions would be vertically integrated into the CFE.

- CFE would be granted broadest discretionary powers with respect to the planning, control and regulation of electricity generation and dispatch, including that carried out by private companies.
- CFE would determine the tariffs for energy wheeling and distribution.
- All electricity generation permits awarded to date and outstanding applications at the CRE would be withdrawn.
- All electricity sales agreements in force between CFE and private operators would be cancelled.
- Clean Energy Certificates would also be revoked.
- Congress would have 180 days to make the necessary adjustments to the applicable legal framework and all provisions that are contrary to the Reform Proposal would be repealed.

Approval procedure

The procedure for adding to or reforming the constitution is provided for in article 135 of the Political Constitution of the United Mexican States. Accordingly, the Reform Bill, once discussed, must be approved by a two-thirds majority; in other words, the qualified majority of the individuals present in each House of the Congress of the Union (Deputies and Senators) sitting in plenary session is required.

In addition, the Reform Bill must be approved by an absolute majority (50% plus one vote) of the local congress of each of the federative entities and the City of Mexico. The Congress of the Union or, where appropriate, the Permanent Commission, would cast the votes of the local congresses and declare the approval of the proposed Reform.

If the proposed bill of amendments is approved, it would be published and come into force on the day following its publication in the Official Gazette of the Federation by the Executive Branch of the Federal Government.

Possible investor protection mechanisms

Unlike what occurs in other legal systems, in Mexico nationalization implies that where an activity constitutes public policy it can only be carried out by the State. This would be subject to a constitutional reform declaring that the activity in question can only be carried out by the State. In the past, the nationalization of the hydrocarbons, electricity and banking industries was accompanied by the expropriation of privately-owned assets so that the State could engage in such activities.

The Reform Bill does not per se propose any expropriation of assets. However, if, as a result of such private electricity generation limitations, foreign investors are deprived of the expected return on their investments to such an extent that it could be equated to the effects of an expropriation, investors might consider and, as the case may be, resort to the defenses contained in the international treaties for the promotion and reciprocal protection of investments entered into by Mexico, as well as the multilateral trade and investment treaties signed by Mexico, the most noteworthy being the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) and the United States-Mexico-Canada Agreement (USMCA).

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